UNITED STATES DISTRICT COURT
DISTRICT OF MAINE

JOHN J. GORMAN, et al.,	)	
	)	
Plaintiffs	)	
	)	
v.	)	
	)	
H. WILLIAM COOGAN, JR., et al.,	)	
	)	
Defendants	)	***Docket No. 03-173-P-H***
	)	
and	)	
	)	
FIRSTMARK CORPORATION,	)	
	)	
Nominal Defendant	)	
	)	

RECOMMENDED DECISION ON DEFENDANTS' MOTION FOR SANCTIONS AND RECOMMENDED FINDINGS PURSUANT TO 15 U.S.C. § 78u-4(c)

In the wake of dismissal of the federal securities-law claims in this action for failure to state a claim as to which relief can be granted, *see* Memorandum Decision on Defendants' Motion for Hearing and Recommended Decision on Defendants' Motions To Dismiss ("Recommended Decision") (Docket No. 64); Order Adopting Report and Recommendations (Docket No. 68), defendants Firstmark Corporation ("Firstmark" or "Company"), H. William Coogan, Jr., Susan C. Coogan (together, "Coogans"), Donald V. Cruickshanks, R. Brian Ball, Robert R. Kaplan, John T. Wyand and John D. McCown (collectively, "Defendants") move pursuant to Federal Rule of Civil Procedure 11 for sanctions against the plaintiffs'

attorneys and their law firm. *See* Defendants' Motion for Sanctions ("Motion for Sanctions") (Docket No. 69) at 1.[1]

Beyond this, as the Defendants observe, *see id.*, the Private Securities Litigation Reform Act ("PSLRA") imposes an independent obligation on the court, "upon final adjudication" of a private securities-law action, to assess each party's and each attorney's Rule 11 compliance "as to any complaint, responsive pleading, or dispositive motion," 15 U.S.C. § 78u-4(c)(1). Judge Hornby referred both the Motion for Sanctions and the PSLRA-mandated task of review for Rule 11 compliance to me. *See* Docket (entry of March 31, 2004); Order on Defendants' Motion for Sanctions ("Sanctions Order") (Docket No. 94) at 8. Although the question whether a Rule 11 motion for sanctions is dispositive or non-dispositive is unresolved in this circuit, *see, e.g.*, *Lancelloti v. Fay*, 909 F.2d 15, 17 n.2 (1st Cir. 1990) (declining to decide this "vexing standard-of-review question"), in an abundance of caution I have framed this opinion as a recommended decision, *see, e.g., Retired Chicago Police Ass'n v. City of Chicago*, 76 F.3d 856, 869 (7th Cir. 1996) (noting that, in face of split among circuits, the Court of Appeals for the Seventh Circuit had chosen to adopt "reasoning that a request for sanctions, regardless of when made, is a dispositive matter capable of being referred to a magistrate judge only under § 636(b)(1)(B) or § 636(b)(3).")[2]

With the benefit of thorough briefing as well as a combined evidentiary hearing and oral argument held before me on October 18, 2004 ("Rule 11 Hearing"), I recommend that the court grant in part and deny in part the Motion for Sanctions and, in accordance with 15 U.S.C. § 78u-4(c)(3)(A)(ii) and Rule 11, impose sanctions against the plaintiffs' attorneys and their law firm, payable to the Defendants, in an amount

[1] Although the Motion for Sanctions refers to Wyand as "John M. Wyand," *see* Motion for Sanctions at 1, the Docket reflects that he consistently has been referred to as "John T. Wyand." *See generally* Docket.

[2] A companion motion by the Defendants to alter or amend the judgment entered in this case remains under advisement to Judge Hornby. *See* Defendants' Motion To Alter or Amend Judgment, etc. (Docket No. 72); Docket (entry of March 31, (*continued on next page*)

equal to reasonable attorney fees and other expenses incurred as a direct result of the plaintiffs' attorneys' violation of Rule 11(b)(2) in bringing a frivolous claim pursuant to section 14(a) of the Williams Act (embodied in Count X of the complaint) and pressing successive frivolous arguments in an attempt to save it.

I. Applicable Law

A. Federal Rule of Civil Procedure 11

Federal Rule of Civil Procedure 11 provides in relevant part:

> **(b) Representations to Court.** By presenting to the court (whether by signing, filing, submitting, or later advocating) a pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances, –
>
> > **(1)** it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;
> >
> > **(2)** the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;
> >
> > **(3)** the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and
> >
> > **(4)** the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

Fed. R. Civ. P. 11(b). A court may impose sanctions for violation of any one or more of these duties either upon motion of a party or on its own initiative. *Id*. § (c)(1). With respect to motions for sanctions, the rule provides:

2004).

> A motion for sanctions under this rule shall be made separately from other motions or requests and shall describe the specific conduct alleged to violate subdivision (b). It shall be served as provided in Rule 5, but shall not be filed with or presented to the court unless, within 21 days after service of the motion (or such other period as the court may prescribe), the challenged paper, claim, defense, contention, allegation, or denial is not withdrawn or appropriately corrected. If warranted, the court may award to the party prevailing on the motion the reasonable expenses and attorney's fees incurred in presenting or opposing the motion. Absent exceptional circumstances, a law firm shall be held jointly responsible for violations committed by its partners, associates, and employees.

Id. § (c)(1)(A).

"The mere fact that a claim ultimately proves unavailing, without more, cannot support the imposition of Rule 11 sanctions." *Protective Life Ins. Co. v. Dignity Viatical Settlement Partners, L.P.*, 171 F.3d 52, 58 (1st Cir. 1999).

B. PSLRA Mandatory Rule 11 Review

Congress passed the PSLRA in 1995 "to give 'teeth' to Rule 11, recognizing the need to reduce significantly the filing of meritless securities lawsuits without hindering the ability of victims of fraud to pursue legitimate claims, and because existing Rule 11 ha[d] not deterred abusive securities litigation." *Gurary v. Winehouse*, 235 F.3d 792, 797 (2d Cir. 2000) (citations and internal punctuation omitted). The PSLRA, which "does not alter the substantive standards for finding a Rule 11 violation but circumscribes courts' discretion in choosing whether to conduct the Rule 11 inquiry at all and whether and how to sanction a party once a violation is found[,]" *id*. (citation and internal quotation marks omitted), provides, in relevant part:

> **(c) Sanctions for abusive litigation**
>
> **(1) Mandatory review by court**
>
> In any private action arising under this chapter, upon final adjudication of the action, the court shall include in the record specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion.

(2) Mandatory sanctions

If the court makes a finding under paragraph (1) that a party or attorney violated any requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion, the court shall impose sanctions on such party or attorney in accordance with Rule 11 of the Federal Rules of Civil Procedure. Prior to making a finding that any party or attorney has violated Rule 11 of the Federal Rules of Civil Procedure, the court shall give such party or attorney notice and an opportunity to respond.

(3) Presumption in favor of attorneys' fees and costs

(A) In general

Subject to subparagraphs (B) and (C), for purposes of paragraph (2), the court shall adopt a presumption that the appropriate sanction –

(i) for failure of any responsive pleading or dispositive motion to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation; and

(ii) for substantial failure of any complaint to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred in the action.

(B) Rebuttal evidence

The presumption described in subparagraph (A) may be rebutted only upon proof by the party or attorney against whom sanctions are to be imposed that –

(i) the award of attorneys' fees and other expenses will impose an unreasonable burden on that party or attorney and would be unjust, and the failure to make such an award would not impose a greater burden on the party in whose favor sanctions are to be imposed; or

(ii) the violation of Rule 11(b) of the Federal Rules of Civil Procedure was de minimis.

(C) Sanctions

> If the party or attorney against whom sanctions are to be imposed meets its burden under subparagraph (B), the court shall award the sanctions that the court deems appropriate pursuant to Rule 11 of the Federal Rules of Civil Procedure.

15 U.S.C. § 78u-4(c).

II. Procedural Context

On May 4, 2004, following Judge Hornby's referral of the Motion for Sanctions to me, I issued a notice pursuant to 15 U.S.C. § 78u-4(c)(2) in which I stated that I had determined that plaintiff John J. Gorman and/or plaintiffs' counsel Richard A. Goren, Esq., and Sean T. Carnathan, Esq. (collectively, "Respondents"), might have violated Federal Rule of Civil Procedure 11(b) in certain respects. *See* Notice of Hearing ("Initial Hearing Notice") (Docket No. 76) at 1.[3] Specifically, I noted that Goren and Carnathan might have violated Rule 11(b)(2) by asserting what appeared to have been (i) a frivolous claim for damages pursuant to section 13(d) of the Williams Act, which they continued to press until October 14, 2003 despite twice having been put on notice of its meritlessness by the Defendants, (ii) a frivolous claim pursuant to section 14(a) of the Williams Act, which they continued to press and refine in an ultimately unsuccessful attempt to save it despite having twice been put on notice of its meritlessness by the Defendants, and (iii) two tender-offer-related claims pursuant to sections 14(d) and 14(e) of the Williams Act that appeared to be frivolous on the basis of lack of "loss causation," which they continued to press after having been put on notice of their meritlessness via the Motion for Sanctions. *See id*. at 2-3.

I further observed that I was persuaded that there was a serious question of possible violation of Rule 11(b)(1) on the part of Gorman, Goren and/or Carnathan inasmuch as, although there was no direct

[3] Although the Respondents have also been referred to in these Rule 11 proceedings as "Plaintiffs," I use the term (*continued on next page*)

evidence of improper purpose, one could reasonably infer intent to harass the Defendants and/or needlessly increase their cost of litigation as a result, *inter alia*, of (i) the backdrop to this litigation (after Gorman and Coogan apparently had settled a previous lawsuit over control of Firstmark, disagreements had continued to fester and they were back in the same fight for control), (ii) the filing of a ninety-three page purportedly "verified" complaint replete with non-cognizable allegations, including subjective characterizations and outright vituperation, and (iii) tenacity in continuing to press even apparently frivolous claims in the face of service of the Motion for Sanctions. *See id*. at 3-4.

I set a hearing for June 10, 2004, noting that to the extent any one or more of the Respondents proposed to present, at hearing, any documentary or testimonial evidence bearing on the question of improper purpose or rebuttal, if any, pursuant to 15 U.S.C. § 78u-4(c)(3)(B), he should file with the court by May 17, 2004 a detailed specification of the evidence proposed to be presented as well as a good-faith estimate of the time required for direct presentation of any proposed testimonial evidence. *See id*. at 1, 4. Any objection to proposed evidence was to be filed by May 24, 2004. *See id*. at 4.

In the wake of issuance of the Initial Hearing Notice the Respondents filed several successive motions to extend time and/or to continue the hearing, all of which were granted. *See* Docket Nos. 80-81, 88-89, 92-93. In addition, on May 17, 2004 the Respondents filed an objection to the Initial Hearing Notice and motion to stay the proceedings pending the court's review. *See* Objection and Motion for Reconsideration by U.S. District Judge Hornby of the Notice of Hearing (and Its Proposed Findings and

"Respondents" in this context to avoid confusion with the named plaintiffs.

Orders) Issued on May 4, 2004, and Motion To Stay Proceedings Under the Notice Pending the Court's Review ("Hearing Objection") (Docket No. 85).[4]

Via the Hearing Objection, the Respondents requested that Judge Hornby (i) vacate the Initial Hearing Notice and handle this matter himself on the ground of lack of magistrate-judge authority or, alternatively, in the exercise of his discretion, or (ii) vacate the Initial Hearing Notice on the basis of a substantive *de novo* review of what the Respondents termed its "initial proposed findings," the merits of which they addressed. *See generally* Hearing Objection. The Defendants filed a brief opposing the Hearing Objection, *see* Docket No. 90, in response to which the Respondents filed a reply memorandum, *see* Docket No. 91.

By decision dated June 9, 2004 Judge Hornby overruled the Respondents' objection. *See* Sanctions Order. In so doing he observed, *inter alia*: "The plaintiffs . . . say there should be no hearing at all, or at least not of the scope detailed in the Notice of Hearing. Obviously they mean that the court should rule in their favor without a hearing, not in the defendant's favor. But the plaintiffs are free to waive the hearing. It is, after all, for their benefit. Whether that is strategically advisable only they can determine." *Id.* at 7.

On June 18, 2004 I held a status conference with counsel at which I directed the Respondents and the Defendants to confer regarding the scope of the contemplated Rule 11 hearing and to submit by July 9, 2004 (i) a joint proposal if possible or, (ii) failing that, a partial joint submission and/or separate positions on the question of scope of hearing. *See* Docket No. 96. On July 9 the Respondents and the Defendants

[4] As of the time of filing of Docket Nos. 80 and 85, Goren and Carnathan were represented by counsel Russell B. Pierce, Jr. and Jonathan W. Brogan. Gorman, who was in the process of obtaining separate counsel, joined in those motions *pro se*. *See* Docket Nos. 80, 85. In connection with this matter, Gorman subsequently retained attorneys Joseph H. Groff III and Brendan P. Rielly. *See* Docket No. 86.

submitted separate briefs. *See* Plaintiffs' Brief on Scope of Hearing ("Respondents' Scope of Hearing Brief") (Docket No. 97); Defendants' Proposal Regarding Scope of Sanctions Hearing and Related Issues ("Defendants' Scope of Hearing Brief") (Docket No. 98). Both sides agreed that (i) this opinion should take the form of a recommended decision and, (ii) for purposes of the hearing, it was unnecessary to delve into the truth of the factual allegations of the complaint; beyond that, they could not reach consensus. *See* Respondents' Scope of Hearing Brief at 1, 5; Defendants' Scope of Hearing Brief at 3, 7.

On July 21, 2004 I held another status conference with counsel at which counsel affirmed that there was no issue regarding the adequacy of factual investigation undertaken prior to filing of the complaint (in other words, there was no Rule 11(b)(3) issue). *See* Report of Conference of Counsel and Order ("Second Hearing Notice") (Docket No. 101) at 2. At that time I also ruled that:

1. Goren and Carnathan (together, "Attorneys") would be permitted to file, by August 6, 2004, a written submission addressing the three potential Rule 11(b)(2) (*i.e.*, frivolousness) violations identified in the Initial Hearing Notice, to which the Defendants would be permitted to file a response by August 20, 2004. *See id*. at 2.

2. To the extent that any one or more of the Respondents or the Defendants proposed to present, at hearing, any evidence bearing on the question of a possible Rule 11(b)(1) (*i.e.*, improper-purpose) violation or rebuttal, if any, pursuant to 15 U.S.C. § 78u-4(c)(3)(B), he or they should file by August 6, 2004, a detailed specification of evidence proposed to be presented, to which any objection should be filed by August 20, 2004. *See id*. at 2-3.

3. I would not accept any evidence *ex parte*. *See id*. at 3.

4. I would not consider state-law claims raised in the complaint, the merits of which never were reached inasmuch as this court declined to exercise its supplemental jurisdiction over them. *See id*.

5. I would hold one unified hearing at which I would take such evidence, if any, as was proffered and permitted in accordance with the foregoing and would hear oral argument bearing on the Rule 11(b)(1) and 11(b)(2) issues. *See id*.

In accordance with this order, on August 6, 2004 the Attorneys filed a memorandum of law addressing the merit of the three Rule 11(b)(2) points of concern raised in the Initial Hearing Notice, *see* Plaintiffs' Attorneys' Memorandum of Law in Response to Notice of Hearing ("Attorneys' Pre-Hearing Memo") (Docket No. 103), and both sides filed specifications of proposed evidence, *see* Defendants' Specification of Evidence Pursuant to Notice of Hearing (Docket No. 102); Plaintiff's Specification of Evidence Pursuant to Report of Conference of Counsel and Order (Docket No. 104). On August 20, 2004 the Respondents filed objections to the Defendants' specification of proposed evidence, *see* Plaintiffs' Objections to Defendants' Specification of Evidence (Docket No. 107), and the Defendants filed responses to both the Attorneys' legal memorandum and the Respondents' specification of proposed evidence, *see* Defendants' Response to Plaintiffs' Attorneys' Memorandum of Law in Response to Notice of Hearing ("Defendants' Pre-Hearing Memo") (Docket No. 105); Defendants' Response to Plaintiff's Specification of Evidence (Docket No. 106).

By order issued September 23, 2004 I ruled on the Respondents' evidentiary objections and set a date of October 18, 2004 for the contemplated unified hearing. *See* Notice of Hearing and Ruling on Evidentiary Objections (Docket No. 108). On the designated day, a full-day hearing was held before me during which (i) all three Respondents appeared, represented by counsel, (ii) four witnesses (including all three Respondents) testified, (iii) fifteen exhibits were offered and admitted, and (iv) counsel argued orally on both the Rule 11(b)(1) and 11(b)(2) issues. *See, e.g.*, Docket Nos. 109-11. At the outset of the

hearing counsel for the Respondents stated, and I acknowledged, that their participation in the proceeding did not effectuate a waiver of previous objections interposed in these Rule 11 proceedings.

III. Proposed Findings of Fact

1. On August 6, 2002 the Coogans filed a verified complaint against Firstmark and its so-called "Texas Directors" – Firstmark Board of Directors ("Board") members Gorman, Arch Aplin III, Robert J. Ellis and Charles H. Mayer – alleging, *inter alia*, that following the Coogans' acquisition of majority shareownership of the company and the call of H. William Coogan, Jr. ("Coogan") for a substitute annual meeting at which, among other things, directors would be elected, the Texas Directors had wrongfully voted to remove Coogan as president and chief executive officer of the Company and chairman of the Board in an attempt to forestall or "rig" the lawfully called election. *See* Verified Complaint, *Coogan v. Firstmark Corp*., No. 02-165-P-H (D. Me.) ("*Coogan v. Firstmark"*), Defendant's Exh. 1, ¶¶ 1-4, 60-68, 73-82. The Coogans sought an order enjoining Firstmark, *inter alia*, from taking any action to prevent or delay the annual meeting (then scheduled for September 6, 2002) or from removing Coogan from his Firstmark posts prior to that annual meeting. *See id*. at 16-17.

2. The following day, Judge Hornby presided at a hearing on the Coogans' motion for a temporary restraining order ("TRO"). *See* Transcript of Proceedings, *Coogan v. Firstmark* (D. Me. Aug. 7, 2002), Defendant's Exh. 2, at 1,4. At that hearing Bryce Tarzwell, attorney for Firstmark, stated that it appeared that Coogan had violated securities laws in obtaining control of the corporation by, *inter alia*, failing to file a tender-offer schedule or amend his Form 13D. *See id*. at 11. Tarzwell sought "some time to figure out whether Mr. Coogan's actions are appropriate and lawful." *Id*. at 12. He advised, "I think the relief the corporation will ultimately be seeking is that Mr. Coogan's shares, the shares he purchased we believe in violation of the law, that he not be able to enjoy the benefits of those shares until he's complied

with the Williams Act. Now if that means he's not entitled to vote the shares at the meeting, so be it." *Id*. at 20.

3. Gorman, who is the chairman of a securities firm and a licensed broker, also suspected at that time that Coogan might have violated federal securities law in acquiring a majority block of Firstmark shares.

4. On August 23, 2002 the parties to *Coogan v. Firstmark* entered into a settlement agreement that provided, *inter alia*, that (i) the Texas Directors (Gorman, Aplin, Mayer and Ellis) would resign without qualification their respective directorships and any and all other offices or positions any of them held with Firstmark or any subsidiary, (ii) the defendants would consent to entry of a preliminary injunction that, among other things, restrained the Texas Directors from taking any action to challenge or change the record date of August 9, 2002 established for the substitute annual meeting or challenge or change the meeting date itself, (iii) on the next business day following that meeting, the plaintiffs would file an amended complaint removing allegations contained in paragraphs 2, 33 and 37 of the original complaint, and (iv) once the amended complaint was filed, the plaintiffs would file a motion to dismiss the action without prejudice. Letter dated August 23, 2002 from Paul D. Anders to Robert S. Frank, Esq. ("Settlement Agreement"), Defendant's Exh. 9, ¶¶ 2-5 & Exh. A thereto.

5. The allegations of paragraphs 2, 33 and 37 of the *Coogan v. Firstmark* complaint were so-called "share parking" allegations. Gorman's attorney had specifically negotiated for their deletion.

6. On August 23, 2002 – the same day as the parties entered into the Settlement Agreement – the Texas Directors resigned from the Board. *See* Plaintiffs' Verified Complaint, Including Derivative Claims (Jury Trial Demanded) ("Complaint") ¶ 191. Three days later, on August 26, 2002, Susan Coogan was appointed a director and Coogan was reinstated as chairman of the Board and president and chief

executive officer of the company. *See id*. ¶ 192. The "interim caretaker Board" consisted of the Coogans and Ali Ezami. *See id* ¶ 193.

7. The shareholder meeting at which directors were elected was held on October 4, 2002 ("October 2002 Election"). *See id*. ¶¶ 220, 222. Voting inspector Keith Jones certified that proxies from the holders of 5,183,217 shares were present, constituting a quorum, and that by a vote of 5,182,692 shares Coogan's slate of seven directors was elected. *See id*. ¶ 223.

8. On October 7, 2002 the Coogans filed an amended complaint in *Coogan v. Firstmark* deleting paragraphs 2, 33 and 37 of their original complaint. *See* Docket, *Coogan v. Firstmark* (entry of Oct. 7, 2002). They then voluntarily dismissed their case without prejudice. *See id*.

9. In the months following the October 2002 Election, Gorman became increasingly alarmed about the direction in which Firstmark was headed. The Company began doing poorly financially; four of the seven directors of the Board resigned; Ezami, whom Gorman had been told while he was on the Board was "the critical, key component" to the success of its aerospace business, was fired; a number of other Firstmark employees were laid off; and finally Coogan announced his intention to deregister Firstmark with the SEC and take it private. During this period of time, Gorman fielded phone calls from other Firstmark shareholders inquiring what was going on. The deregistration, which was slated to become final at the end of June 2003, was of particular concern to Gorman because it would deprive him and other shareholders of the benefit and requirement of publicly filed disclosure.

10 When Gorman was asked at the Rule 11 Hearing whether it was fair to say that when he filed the Complaint, he was "principally concerned with what is described in the Complaint as basically Coogan's looting of the company," he agreed.

11. In early April 2003 Gorman hired the law firm of Rubin, Hay & Gould, P.C. ("Rubin, Hay"), of Framingham, Massachusetts, to conduct an investigation into possible wrongdoing by Coogan and his associates. Attorney Richard A. Goren took charge of the investigation and served as the lead theorist for the case. Goren, who has been practicing law since 1974, primarily in the area of complex litigation, is a graduate of Boston State College (B.S., 1969), Suffolk University Law School (J.D., cum laude, 1974) and Boston University (L.L.M., taxation, 1975).

12. As part of his investigation, Goren obtained all Securities and Exchange Commission ("SEC") filings he could find under the names of Coogan and Firstmark and interviewed former Firstmark employees, officers and directors, including former counsel Tarzwell and former director and manager Ezami (who had been fired in January 2003).

13. In late May 2003 attorney Sean T. Carnathan joined Rubin, Hay. Carnathan is a graduate of Bowdoin College (A.B., magna cum laude, 1986), the University of Maine School of Law (J.D., summa cum laude, 1993) and Harvard Law School (L.L.M., intellectual property, 1997). Prior to joining Rubin, Hay he had clerked for Maine Supreme Judicial Court Justice Paul Rudman and worked for five years for the law firm of Hale and Dorr. He had worked on several securities-fraud cases.

14. Carnathan promptly began assisting Goren on the Gorman matter. Whereas Goren had focused initially on researching the facts that would underpin the case, Carnathan set about conducting legal research, both directly and through supervision of the work of associates of the firm, and maintaining a checklist of claims, elements and anticipated defenses. He also reviewed voluminous documentation, including the Settlement Agreement. He was aware that issues had been raised in the context of the previous suit concerning whether Coogan had violated federal securities laws in acquiring a controlling piece of the shares of Firstmark, including section 13(d) and the tender-offer sections of the Williams Act. He

also was aware that, at the time of the Settlement Agreement, the parties understood that the October 2002 Election was to be uncontested. He concluded that maintenance of the instant action was not precluded on theories of *res judicata*, waiver or estoppel or by the terms of the Settlement Agreement itself.

15. From late May 2003 until approximately mid-July 2003 Goren and Carnathan worked virtually full-time on this matter, putting in eleven- and twelve-hour days. Goren pressed on with his investigation, among other things obtaining additional documents from Maine agencies and interviewing additional individuals, including SEC employees and Jim Vigue, who had founded Firstmark. He devoted hundreds of hours to preparing the case, in his view, to the best of his ability.

16. On June 11, 2003 Goren traveled to Richmond, Virginia, to inspect Firstmark documents in the presence of Paul D. Anders, an attorney with the law firm of LeClair Ryan of Richmond. Goren, whom Anders described as having been "animated," made several comments, either to Anders or to no one in particular, that struck Anders as unusual, including that Coogan was "dirty," Coogan or someone was backdating documents, he (Goren) was going to "hurt" Coogan "real bad," and "Brian Ball, you're in trouble."

17. These comments were made in the context of an ongoing contentious debate between attorneys for both sides as to the scope of material the Plaintiffs were entitled to review. Goren believed that attorneys for the Defendants were withholding documents that he was entitled to see, while attorneys for the Defendants believed that Goren was seeking far more than that to which he was entitled.[5]

[5] Goren initially drafted stockholder inspection demands on behalf of Gorman and plaintiff Kurt J. Rechner, who held themselves out to be holders "of record" of Firstmark common stock. *See, e.g.*, Defendants' Exh. 16. After Goren was informed that neither Gorman nor Rechner was a holder "of record" and thus neither was entitled to inspect the corporation's books and records, *see, e.g.*, Defendant's Exh. 17, he prepared an inspection demand on behalf of plaintiffs Phil A. Whitney and Karin Whitney (together, "Whitneys"), *see* Plaintiff's Exh. 25A. It was pursuant to the Whitney inspection demand that Goren traveled to Richmond to inspect corporate records.

18. When Goren reviewed documents at Coogan's office in Virginia, he discovered, and called to Anders' attention, a number of problems, including that many of the documents produced were copies rather than originals, some meeting minutes were missing altogether and some were unsigned. He became, by his own description, "quite upset."

19. Goren, who testified that he is "not a particularly reserved person," stated that the comments he made of which Anders took note were exclamations that related to the materials he was reviewing (for example, he did find a backdated document), that he had no personal animus against Coogan and in fact as of that date had never met him.

20. The Goren investigation turned up what appeared to Goren to be wrongdoing dating from 1996 of which Gorman previously had been unaware, including an allegedly unconscionable merger agreement between Coogan's title-insurance company and Firstmark in 1996 and an allegedly void and self-dealing conversion of Firstmark preferred stock into common stock by the Coogans and their former business associate Cruickshanks in 1997.

21. At the conclusion of the investigation Goren and Carnathan weighed whether their clients had viable claims. They were assisted in this task by at least one Rubin, Hay partner and several Rubin, Hay associates.

22. Carnathan, who served as lead draftsman, prepared a number of drafts of a complaint. Gorman reviewed and commented on the drafts; however, he relied on counsel to devise the legal theories underpinning the complaint.

23. On July 10, 2003 Gorman, Rechner and the Whitneys (collectively, "Plaintiffs") filed the instant ninety-three-page complaint. *See* Complaint at 1. Gorman and Rechner brought suit individually and derivatively on behalf of Firstmark, while the Whitneys sued individually on behalf of themselves and all

others similarly situated and derivatively on behalf of Firstmark. *See id*. The Complaint described Gorman as the beneficial owner of 1,286,788 shares of Firstmark common stock, Rechner as the beneficial owner of 20,000 such shares and the Whitneys as the record owners of 3,289 such shares. *See id*. ¶¶ 12-14.

24. The Complaint outlined a series of alleged wrongdoings by Coogan and his asserted co-conspirators beginning in 1996, when the Coogans and Cruickshanks merged their title-insurance business with Firstmark, and continuing through the date of filing of the action. *See, e.g., id*. ¶¶ 2-11 (summarizing principal allegations).

25. In addition to seeking monetary relief sufficient to compensate the Plaintiffs for their losses, *see id*. at 93, the Complaint sought, *inter alia*, (i) a declaration of the invalidity of 2,180,286 shares of Firstmark common stock owned by the Coogans and Cruickshanks on the basis of asserted state-law violations dating back to 1996, *see id*. ¶¶ 1, 299-300, (ii) so-called "sterilization" (or disenfranchisement) of the 477,701 control-piece shares Coogan acquired in the summer of 2002 as a remedy for asserted violations of sections 13(d), 14(d) and 14(e) of the Williams Act, *see id.* ¶¶ 291-95, 307-25; Plaintiffs' Opposition to Defendants' Motions To Dismiss ("Dismiss Opposition") (Docket No. 45) at 6,[6] (iii) invalidation of the October 2002 Election on the basis of lack of a quorum and fraud in violation of section 14(a) of the Williams Act, *see* Complaint ¶¶ 300, 302-06, 359, and (iv) the ordering of a new election, *see id*. ¶ 359.

26. At the Rule 11 Hearing Carnathan acknowledged that to obtain the relief the Plaintiffs were seeking, "we needed to win big." If, for example, the court voided the October 2002 Election and ordered a new one but the Plaintiffs did not prevail on their claims that the Coogan shares were void or should be

[6] The Complaint alleges that Coogan acquired 477,702 shares in summer 2002, *see* Complaint ¶ 309; however, the Plaintiffs (*continued on next page*)

disenfranchised, Coogan still would own 50.7 percent of the voting shares of Firstmark and thus would be able to win an election rematch.

27. The Complaint contained nineteen counts, five of which asserted substantive federal securities-law claims ("Williams Act Claims"). *See id*. ¶¶ 262-359. The Williams Act Claims formed the predicate for federal jurisdiction. *See id*. ¶ 23. In Counts VIII and XIII (parallel claims, one direct and one derivative, on behalf of Firstmark), the Plaintiffs alleged that Coogan had violated section 13(d) of the Williams Act, 15 U.S.C. § 78m(d), by failing to amend his Form 13D to disclose in a timely fashion his intention to buy sufficient shares to take control of Firstmark. *See id*. ¶¶ 291-94, 321-25. In Count X (a direct claim), the Plaintiffs alleged that Coogan had violated section 14(a) of the Williams Act, 15 U.S.C. § 78n(a), by disseminating fraudulent proxy statements in connection with the October 2002 Election. *See id*. ¶¶ 302-06. Finally, in Counts XI and XII (direct claims), the Plaintiffs alleged that Coogan had violated two tender-offer provisions of the Williams Act, section 14(d), 15 U.S.C. § 78n(d), and section 14(e), 15 U.S.C. § 78n(e), by engaging in June 2002 in what amounted to a tender offer without complying with tender-offer rules and by making fraudulent misrepresentations and omissions in connection therewith. *See id*. ¶¶ 307-20.

28. On the same day that the Plaintiffs filed the Complaint, they filed motions (i) for a limited *ex parte* TRO and (ii) a broader TRO and preliminary injunction. *See* Plaintiffs' Motion for Limited Ex Parte Temporary Restraining Order ("Limited TRO Motion") (Docket No. 11); Plaintiffs' Motion for a Temporary Restraining Order and Preliminary Injunction ("TRO/PI Motion") (Docket No. 13). The Limited TRO Motion sought a limited restraining order, to last only until the hearing on the accompanying

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subsequently referred to the number acquired as 477,701, *see, e.g*., Dismiss Opposition at 14 n.4. Nothing turns on this (*continued on next page*)

TRO/PI Motion, enjoining the Board from advancing any Company money to Board members to pay for legal expenses in the instant action. *See* Limited TRO Motion at 2. Judge Hornby granted that limited motion on July 11, 2003. *See* Limited Ex Parte Temporary Restraining Order (Docket No. 17).

29. The TRO/PI Motion sought an order "enjoining the invalidly constituted Board from purporting to act on Firstmark's behalf and enjoining Coogan, Susan Coogan and Crui[c]kshanks from selling, conveying, pledging or otherwise transferring any stock in Firstmark, pending a resolution of this dispute." TRO/PI Motion at 3.

30. In an opposition to the TRO/PI Motion, Firstmark argued, *inter alia*, that Counts VIII and XIII failed to state a claim inasmuch as (i) the filing of a curative Form 13D amendment forecloses a claim for injunctive relief, and (ii) there is no private right of action pursuant to section 13(d), whether brought on behalf of the issuer or shareholders. *See* Firstmark Corporation's Opposition to Plaintiffs' Motion for a Temporary Restraining Order and Preliminary Injunction ("TRO/PI Opposition") (Docket No. 24) at 9, 11.

31. With respect to this point, the Plaintiffs rejoined:

> Plaintiffs pleaded their section 13(d) claim both directly and derivatively because the law in this regard is unsettled. In the derivative context, Coogan's contention that Plaintiffs have no claim for damages based upon section 13(d) is nonsensical, because Plaintiffs seek injunctive relief, which is available to an issuer, as set forth in the very case upon which Coogan relies. *Hallwood Realty Partners, L.P. v. Gotham Partners, L.P.*, 286 F.3d 613 (2d Cir. 2002). Moreover, a substantial body of case law disagrees with *Hallwood* and recognizes that shareholders also have a cause of action for violation of section 13(d). *See* Lora C. Siegler, *Availability of Implied Private Action for Violation of § 13 of Securities Exchange Act of 1934*, 110 A.L.R. Fed 758 § 8 (2002) (gathering cases).

Plaintiffs' Reply in Support of Their Motion for a Temporary Restraining Order and Preliminary Injunction ("TRO/PI Reply") (Docket No. 29) at 5-6.

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discrepancy.

32. At the Rule 11 Hearing Carnathan testified that the Attorneys thought that in stating the above they had clarified that they were not seeking damages via their section 13(d) claim. He acknowledged that the paragraph is not a model of clarity but observed that the Attorneys were working at a high rate of speed to meet the time constraints of the TRO framework.

33. By decision dated July 28, 2003, following a hearing held July 16, 2003, Judge Hornby dissolved the preliminary TRO he had previously entered and denied the motion for a preliminary injunction, primarily on the basis of lack of the requisite showing of irreparable injury and potential harm to the Defendants should the motion be granted. *See* Order on Plaintiffs' Motion for Preliminary Injunction and Request for Temporary Restraining Order (Docket No. 32) at 1, 4-8 .

34. With respect to the Plaintiffs' likelihood of success on the merits, he observed:

> The plaintiffs' lawyers have great confidence in the merits of their clients' position and their papers show that they have gone to great lengths to assemble evidence to document their far reaching charges. Suffice it to say at this point, however, that they also face daunting hurdles. These hurdles include overcoming the applicable statute of limitations for transactions dating back to 1996, challenging the validity of an extant legal opinion supporting the 1996 merger, fashioning an appropriate remedy for any invalid stock issued pursuant to the 1996 merger where the Coogans and Crui[c]kshanks gave something of value in exchange, significant securities laws issues in determining whether the alleged tender offer actually violated the Williams Act, and their success on all of these claims in order to prove the lack of a quorum at the October 2002 meeting of stockholders. The likelihood of success is certainly not enough to overcome the presumption against preliminary injunctive relief that the analysis under factors 1 and 2 produces.

Id. at 9.

35. Following the Plaintiffs' loss on their TRO/PI Motion, the Defendants served them, by transmittal letter dated August 22, 2003, the Motion for Sanctions. *See* Letter dated August 22, 2003 from James T. Kilbreth to Sean T. Carnathan, Esq., Attachment #1 to Letter dated February 27, 2004 from

James T. Kilbreth to William Brownell, Clerk ("Transmittal Letter") (Docket No. 70).[7] The Defendants asserted that at least thirteen of the Complaint's nineteen counts, including all five Federal Claims, were frivolous. *See* Motion for Sanctions at 7-8, 17.

36. Upon receipt of the Motion for Sanctions, Carnathan had an associate pull every case cited. Carnathan personally read each one and engaged in a number of internal discussions with Goren and others at Rubin, Hay about the issues raised. The Attorneys concluded that their theories were sound and that the Complaint stated a federal cause of action. Carnathan held a conference call with Gorman and Rechner in which he advised that he thought (i) the Plaintiffs still had a good chance to survive a motion to dismiss, and (ii) the sanctions motion seemed to be an intimidation tactic inasmuch as it stood only a remote chance of success.

37. The Attorneys' strategy at that point was to survive the Defendants' anticipated motions to dismiss and file a motion for summary judgment on issues that could be decided purely as a matter of law.

38. The Plaintiffs withdrew no claims in response to the Motion for Sanctions during the 21-day Rule 11 safe-harbor period, which expired on September 15, 2003.

39. On September 2, 2003, during the pendency of the safe-harbor period, the Defendants filed four separate motions to dismiss. *See* Docket Nos. 39-41, 43. Of these, the flagship motion was that of Firstmark, Wyand, Kaplan and McCown. *See* Defendants' Motion To Dismiss, etc. ("Motion To Dismiss") (Docket No. 43).

[7] The Respondents have represented, and I accept for purposes of this inquiry, that the date of service of the Motion for Sanctions was actually August 25, 2003. *See* Hearing Objection at 4.

40. On September 15, 2003 the Plaintiffs filed a consented-to motion to extend their deadline to respond to the motions to dismiss to October 14, 2003. *See* Docket No. 44. The motion was granted. *See* Docket (entry of September 17, 2003).

41. On October 14, 2003 the Plaintiffs filed a sixty-page consolidated opposition to the motions to dismiss, accompanied by a thirty-five page summary of the principal misstatements and omissions alleged in the Complaint. *See* Dismiss Opposition; Exh. A to *id*.

42. On October 21, 2003 the Defendants filed a consented-to motion to extend time to reply to the Plaintiffs' opposition to November 10, 2003, *see* Docket No. 49, which was granted, *see* Docket No. 50. The flagship reply memorandum was again filed by Firstmark, Kaplan, Wyand and McCown, *see* Defendants' Reply to Plaintiffs' Opposition to Defendants' Motion To Dismiss ("Dismiss Reply") (Docket No. 55).

43. The Plaintiffs sought, and were granted, leave to file a surreply (over the Defendants' objection). *See* Docket Nos. 57-59, 61-62.

44. By decision dated January 13, 2004 I recommended that all of the Williams Act Claims be dismissed for failure to state a claim as to which relief can be granted and that the court decline to exercise jurisdiction over the remaining pendent state-law claims. *See generally* Recommended Decision.

45. On February 2, 2004 the Plaintiffs filed an objection to the Recommended Decision, *see* Plaintiffs' Objections to the Magistrate's Memorandum Decision on Defendants' Motion for Hearing and Recommended Decision on Defendants' Motions To Dismiss ("Objection to Recommended Decision") (Docket No. 65), to which the Defendants filed a response, *see* Defendants' Response to Plaintiffs' Objections to the Magistrate Judge's Recommended Decision ("Response to Objection") (Docket No. 66).

46. In their objection to the Recommended Decision, the Plaintiffs acknowledged, with respect to Count X, that Coogan's "Definitive September 13, 2002 Proxy Statement correctly informed stockholders that if a quorum were present a plurality of even one vote would carry the day." Objection to Recommended Decision at 9. However, they asserted that the proxy statement nonetheless was materially misleading with respect to the manner in which a quorum would be established when construed in light of an August 16, 2002 proxy statement that had been issued by Firstmark. *See id*. at 8-14. They concluded: "To the extent that the Court agrees with the Plaintiffs' analysis as set forth here and in their Opposition and Surreply to the Motions to Dismiss, but the Court finds that Count X of the Verified Complaint as drafted fails to state a claim due to a mere pleading deficiency, the Court should dismiss the Count without prejudice and grant the Plaintiffs leave to amend." *Id*. at 14 (emphasis in original).

47. The Plaintiffs did not, in connection with their objection to the Recommended Decision or at any other time, proffer an amended complaint.

48. In responding to this portion of the Plaintiffs' objection, the Defendants pointed out, *inter alia*:

> [T]his newly-minted argument conveniently glosses over certain rather critical facts. The preliminary proxy statement in question was filed by Firstmark on August 16, 2002. On August 5, *prior to* the filing of that preliminary proxy, the Firstmark board (which included plaintiff Gorman, Aplin, Mayer and Ellis) had removed Mr. Coogan from his position as chairman and chief executive. The August 16 preliminary proxy thus contemplated a *contested* election and urged shareholders to vote against Mr. Coogan's proposed slate of directors. . . . On August 23, following a "brief but intense period of litigation," plaintiff Gorman and his fellow directors resigned as part of the parties' settlement; and on August 26, 2002, Mr. Coogan regained the helm of Firstmark. In short, the August 16 preliminary proxy was not filed by Mr. Coogan and did not relate to the "same" meeting as the September proxies, which (unlike the August 16 preliminary proxy) contemplated an uncontested election. To now charge defendants with failing to correct a preliminary proxy filed by Firstmark while Gorman et al. were in charge shows remarkable chutzpah.

Response to Objection at 6-7 (citations omitted) (emphasis in original).

49. These distinctions are borne out by the Complaint itself, as well as by underlying materials submitted in connection with the TRO/PI Motion. *See* Complaint ¶¶ 189-92, 220-21; *compare* Form PRE 14A dated August 16, 2002, attached as Exh. 12 to Appendix of Documentary Materials Cited in Support of Plaintiffs' Motion for a Temporary Restraining Order and Preliminary Injunction ("Plaintiffs' Appendix"), *with* Form DEF 14A dated September 13, 2002, attached as Exh. 18 to Plaintiffs' Appendix.

50. By order dated February 24, 2004 Judge Hornby adopted the Recommended Decision. *See* Docket No. 68.

51. On February 27, 2004 the Defendants filed the instant Motion for Sanctions in the form in which it had been served on the Plaintiffs the previous August. *See* Transmittal Letter. They stated:

> Obviously, the fact that plaintiffs have remained a proverbial moving target throughout this litigation means that, upon its mandatory Rule 11 review under the PSLRA, the Court will likely find additional grounds for sanctions that could not have been anticipated six months ago when the Sanctions Motion was served. For example, given what defendants understood to be the thrust of plaintiffs' allegations under section 13(d), the Sanctions Motion focused primarily on plaintiffs' lack of entitlement to damages. Thereafter, plaintiffs disclaimed any intention to seek damages and insisted that they sought exclusively to unwind the October 2002 election of Firstmark directors.

Transmittal Letter at 2 & n.1 (citations omitted).

52. On March 1, 2004 the clerk's office entered judgment in favor of the Defendants and against the Plaintiffs. *See* Docket No. 71. As Judge Hornby has since pointed out, this was a clerical error given the pendency of the Motion for Sanctions. *See* Sanctions Order at 2-3.

53. On March 16, 2004 the Plaintiffs filed a brief opposing the Motion for Sanctions, to which the Defendants responded via a reply memorandum filed on March 25, 2004. *See* Docket Nos. 73, 74.

54. At the Rule 11 Hearing, Carnathan acknowledged that an initial argument made in connection with the section 14(a) claim was wrong: that Gorman, Rechner and others would have voted

against the Coogan slate in the October 2002 Election if properly instructed by the Coogan proxy statements. In fact, as Carnathan concedes, there was no option to vote "against" the Coogan slate in that election, which was uncontested.

55. Gorman testified at the Rule 11 Hearing that he did not recall reading any proxy statements issued in connection with the October 2002 Election after entering into the Settlement Agreement. However, as Carnathan theorized, Gorman evidently was confused as to this point. Goren specifically recalled having had a conversation with Gorman in which Gorman stated that he did read those proxies and came away with the understanding that his shares would not be voted for any reason at the October 2002 Election if he did nothing. This understanding is reflected in an affidavit that Gorman signed under oath that was submitted in connection with the TRO/PI Motion. *See* Affidavit of John Gorman in Support of Plaintiffs' Motion for a Preliminary Injunction, attached as Exh. 43 to Plaintiffs' Appendix, ¶ 5 ("I understood from reading the September 13, 2002 proxy materials that if I did not provide instructions for voting the Shares at the Meeting, the Shares would not be voted for the slate of seven (7) Directors nominated by the Defendant, H. William Coogan, Jr.").

56. Gorman testified at the Rule 11 Hearing that he assumed there would be a quorum at the October 2002 Election. Carnathan acknowledged that neither Gorman nor Rechner ever told him that he specifically intended to prevent a quorum at that election.

57. Carnathan had nothing to gain personally in pursuing this matter beyond compensation for legal services performed. He described his purpose as winning this case on the merits, which he believed he could do. Carnathan understood that Gorman was looking for aggressive legal representation; he described Gorman as "as upset as any client I've ever seen," "wild to get into court" and having "an absolute conviction" that Coogan was destroying Firstmark and lining his own pockets. He understood that

Gorman's purposes in bringing this action were to save Firstmark, stop Coogan from destroying the company and lining his own pockets, take back the company, and exonerate Ezami.

58. Carnathan had no discussions with Goren, Gorman or anyone else in which he felt that an improper purpose for this litigation was put forth. Gorman expressed concern to Carnathan about fees incurred on both sides and about winning as expeditiously as possible. As a major shareholder, he felt that in a certain sense he was paying for both sides.

59. During the course of preparing for and pursuing this litigation Goren spoke to Gorman on a number of occasions. Gorman expressed no improper purpose to Goren. Instead, Goren understood Gorman's motives to be to protect the company, to take back control of it if he could, to grow the company and to recoup monies that Coogan appeared to have misappropriated. Goren described Gorman as having been greatly concerned that this litigation not go on a long time, which would hurt everyone and run up fees on both sides.

60. Both Attorneys are familiar with Federal Rule of Civil Procedure 11. Both believe that their conduct in this litigation conformed in all respects with the dictates of that rule. Goren described the complaint in this matter as the "very finest" he has ever signed.

61. On many occasions both prior to and after execution of the Settlement Agreement (including during the course of the current action) Gorman has proposed to Coogan, without success, that one of them buy the other out. *See, e.g.*, Defendants' Exh. 31.

IV. Proposed Conclusions of Law

1. This matter entails both (i) consideration of a motion for sanctions and (ii) mandatory PSLRA Rule 11 review. Accordingly, my first task is to separate issues squarely raised in the Motion for Sanctions from those that have arisen since its service upon the Plaintiffs in August 2003. *See, e.g., Nagel*

v. ADM Investor Servs. Inc., 65 F. Supp.2d 740, 756 (N.D. Ill.1999), *aff'd*, 217 F.3d 436 (7th Cir. 2000) (noting that "Rule 11(c)(1)(A) requires a litigant seeking sanctions to serve privately – without a copy to the court – a motion that 'shall describe the specific conduct alleged to violate subdivision (b)'"; ruling that defendant therefore did not preserve demand for sanctions on bases raised for first time in reply memorandum, with respect to which plaintiff was deprived of twenty-one day safe harbor).

2. Although I undertake an improper-purpose inquiry as part of the court's mandatory PSLRA review (addressed below), such an inquiry is not within the purview of the Motion for Sanctions. The Defendants failed to put the Plaintiffs adequately on notice, for purposes of the Rule 11 safe harbor, that improper purpose was a basis on which they sought withdrawal of the Complaint. *See generally* Motion for Sanctions.

3. In the course of their Rule 11 briefing the Defendants raised a Rule 11(b)(2), or frivolousness, argument that is not found within the four corners of the Motion for Sanctions: that accepting the Plaintiffs' own characterization that the "transaction" challenged in the Williams Act Claims is the October 2002 Election, they still cannot articulate any plausible theory as to how the alleged Williams Act violations affected the outcome of that election. *See* Defendants' Pre-Hearing Memo at 5-8.[8] I consider that argument solely in the context of the mandatory PSLRA review.

A. Motion for Sanctions

4. **Mootness**. The Motion for Sanctions asserted, as a threshold matter, that the Williams Act Claims were frivolous on the basis of mootness. *See* Motion for Sanctions at 2-3. I rejected a parallel

[8] The Defendants first raised this point during briefing of the motions to dismiss. *See* Dismiss Reply at 1-8.

argument as a basis for dismissal of the Complaint, *see* Recommended Decision at 16-17 n.19, and reject it again now, for the same reasons, as a ground for a finding of a Rule 11 violation.

5. **Counts VIII and XIII (section 13(d) claim).** The Motion for Sanctions identified two bases for a finding of frivolousness as to Counts VIII and XIII: that (i) controlling precedent foreclosed a claim for injunctive relief in a case, such as this, in which a "curative" Form 13D amendment has been belatedly filed, *see* Motion for Sanctions at 17 (citing *Hibernia Sav. Bank v. Ballarino*, 891 F.2d 370, 373 (1st Cir. 1989), and *Brunswick Techs., Inc. v. Vetrotex Certainteed Corp.*, No. 00-124-P-H, 2000 WL 761004, at *1 (D. Me. May 2, 2000)), and (ii) there is no implied right of action for damages pursuant to section 13(d), *see id.* at 18-19.

6. The first of these points is readily dispatched. In ruling on the Defendants' motions to dismiss, I agreed with the Plaintiffs that *Hibernia* and *Vetrotex* were distinguishable inasmuch as, in those cases, the offending party had not yet acquired sufficient shares to take control of the target corporation at the time a "curative" amendment was filed. *See* Recommended Decision at 20-21. Counts VIII and XIII thus cannot be said to have been frivolous on the basis that they advanced an argument foreclosed by *Hibernia* and *Vetrotex*.

7. Analysis of the second point is more complicated. The Attorneys seek to stave off sanctions in this regard on the bases that (i) they made clear prior to service of the Motion for Sanctions that they were not pressing a section 13(d) damages claim, (ii) in any event, they were not afforded the full benefit of the Rule 11 safe harbor inasmuch as the Defendants filed their motions to dismiss during the pendency of the twenty-one-day safe-harbor period (diverting the Attorneys' attention), and, (iii) in any event, there is a non-frivolous argument for extension of existing law. *See* Attorneys' Pre-Hearing Memo at 1-11; *see also* Hearing Objection at 13-15.

8. The Complaint did not clarify whether the Plaintiffs sought damages and/or injunctive relief for the asserted violation of section 13(d). *See* Complaint ¶¶ 1, 183-88, 291-95, 321-25, 355-59. The Attorneys say that they supplied that clarification as best they could in their TRO/PI Reply given the time constraints they were then under and their perception that this was, in any event, a minor point in the bigger picture of this complex case. Nonetheless, I conclude that the paragraph of the TRO/PI Reply on which they rely is too abstruse to communicate effectively the simple point that they were not pressing a claim for damages pursuant to section 13(d).[9] Even more troubling, when the Attorneys received the Motion for Sanctions, which made clear that the Defendants remained confused on this point, they did not see fit during the twenty-one-day safe-harbor period to set them straight. The Attorneys' objection that they were not afforded the benefit of the full twenty-one days rings hollow. The rule is clear that a recipient of a motion for sanctions has twenty-one days in which to respond or risk sanctions. No extensions are contemplated because an attorney is busier than he expected to be; in any event, the Attorneys sought and received an extension of time within which to respond to the motions to dismiss. They did not make clear until October 14, 2003, well after the close of the safe-harbor period on September 15, that they did not seek damages pursuant to their section 13(d) claim. *See* Dismiss Opposition at 11 n.3.

[9] In the TRO/PI Reply, the Attorneys stated that the Defendants' section 13(d) damages argument was "nonsensical" in the "derivative context" because they sought injunctive relief, which is available to an issuer. *See* TRO/PI Reply at 5. They then muddied the waters by adding, "Moreover, a substantial body of case law disagrees with *Hallwood* and recognizes that shareholders also have a cause of action for violation of section 13(d)." *Id*. at 6. While, for this proposition, they did cite a section of an American Law Reports ("A.L.R.") article dealing with injunctive relief, not damages, *see id*. (citing Lora C. Siegler, Annotation, *Availability of Implied Private Action for Violation of § 13 of Securities Exchange Act of 1934 (15 U.S.C. § 78M)*, 110 A.L.R. Fed. 758, at § 8 (2002)), the A.L.R. article did elsewhere address the subject of the availability of damages pursuant to section 13(d), *see* Siegler, 110 A.L.R. Fed. 758, at § 10, and the Attorneys seemingly were disagreeing with the holding of *Hallwood* that "there is no private damages remedy for issuers under § 13(d)[,]" *Hallwood*, 286 F.3d at 620. The Attorneys have argued that they should have been understood not to be pressing a claim for damages in this context because, if they had been, they would not have been entitled to the injunctive relief they sought. *See, e.g*., Attorneys' Pre-Hearing Memo at 3. Nonetheless, they could plausibly have been understood to have been making a case, in the alternative, for entitlement to damages.

9. It is a close question whether the contention that damages are available pursuant to section 13(d) is sufficiently colorable in this jurisdiction to avoid being sanctionable. There is a significant body of caselaw flatly holding such damages unavailable, *see, e.g.*, *Hallwood*, 286 F.3d at 618-21; *Stephenson v. Deutsche Bank AG*, 282 F. Supp.2d 1032, 1054 n.18 (D. Minn. 2003) ("Courts . . . have almost universally held that Section 13(d) does not contain a private right of action for money damages."), and the Attorneys are unable to cite to any case affirmatively holding to the contrary, *see* Attorneys' Pre-Hearing Memo at 7-11.

10. Nonetheless, no Supreme Court or First Circuit case holds such damages unavailable, and there is First Circuit dictum on the basis of which one can construct a rational, if likely non-winning, argument that the First Circuit might recognize such a claim. As the Court of Appeals for the Second Circuit observed in *Hallwood*, courts have declined to find an implied right of action for damages pursuant to section 13(d) in part because of "the existence of an express remedy [for damages] under § 18(a) of the Williams Act, available to those shareholders who can prove reliance on misleading [Form 13D] filings." *Hallwood*, 286 F.3d at 619. First Circuit dictum at least suggests that (i) damages are available to those injured by a section 13(d) violation, and (ii) such persons need not show reliance. *See General Aircraft Corp. v. Lampert*, 556 F.2d 90, 97 & n.12 (1st Cir. 1977) ("Investors who bought or sold GAC stock at an unfair price *or* in reliance upon the inaccurate Schedule 13D have an adequate remedy at law by way of an action for damages, thereby negating their entitlement to equitable relief. Thus, for example, the persons who sold the 5600 shares of GAC stock to Lampert and Scuderi on December 31, 1974, while appellants were in violation of Section 13(d) for failure to file the required Schedule 13D, have an adequate remedy at law for damages if they sold their stock at an unfair price as a result of the Section 13(d) violation.") (citations omitted) (emphasis added). The argument goes as follows: To the extent the First Circuit

suggested that one injured by a section 13(d) violation need not demonstrate reliance, it could not have been referring to section 18(a), which requires reliance; arguably, it therefore was signaling that damages are available pursuant to section 13(d) itself.

11. Against the backdrop of the seemingly uniform caselaw holding section 13(d) damages unavailable, this is a thin reed on which to rest a section 13(d) damages argument. Nonetheless, giving the Attorneys the benefit of the doubt, it suffices to avoid a finding of frivolousness. *See, e.g., Rounseville v. Zahl*, 13 F.3d 625, 633 (2d Cir. 1994) ("all doubts are to be resolved in favor of the signer of the document that is the basis for Rule 11 sanctions"); *Edmonds v. Gilmore*, 988 F. Supp. 948, 956-57 (E.D. Va. 1997) (same).

12. **Count X (section 14(a) claim)**. The Defendants moved for sanctions as to Count X on the basis of failure to plead either "transaction" or "loss" causation, both of which are essential elements of a section 14(a) claim. *See* Motion for Sanctions at 20-24. The Motions for Sanctions made clear the frivolousness of this claim on the basis of lack of transaction causation, yet the Attorneys continued to press and refine the claim, propounding additional frivolous arguments in a failed attempt to save it.

13. To state a claim pursuant to section 14(a), a plaintiff must plead transaction causation – that is, that the proxy materials in question were not only materially misleading but also constituted an "essential link" in the accomplishment of a transaction. *See, e.g., Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1087 (1991) (holding transaction causation absent, for purposes of section 14(a) claim, when minority shareholders' votes were not required by law or corporate bylaw to authorize the corporate action that was the subject of the allegedly misleading proxy solicitation); *Royal Bus. Group, Inc. v. Realist, Inc.*, 933 F.2d 1056, 1063 (1st Cir. 1991) (noting, with respect to section 14(a) claim, that plaintiffs' complaint failed "to establish a causal nexus between their alleged injury and some corporate transaction authorized

(or defeated) as a result of the allegedly false and misleading proxy statements. The need to plead and prove a transactional nexus in a proxy solicitation case is not legitimately in doubt.").

14. A securities-fraud claim must be pleaded with particularity. *See, e.g., In re Cabletron Sys., Inc*., 311 F.3d 11, 27 (1st Cir. 2002) ("Under the PSLRA, a securities fraud complaint must specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.") (citation and internal quotation marks omitted).

15. The Complaint alleged, in relevant part:

> 221. In each of the September 5th and the September 13th proxy statements, when describing the required vote and the rule for a quorum, Coogan fraudulently represented that
>
> > If a quorum is present, new directors will be elected by a plurality of the votes cast. This means that the director-nominees receiving the highest number of votes will be elected as directors. Accordingly, abstentions and broker non-votes do not have the effect of a vote against the election of any director-nominees. Brokers will not have discretion to vote shares held in street name without instructions from the beneficial owner of the shares with respect to the proposals under this proxy statement at the Annual Meeting.
>
> ***
>
> 224. As a matter of law, there was no valid quorum for election of directors because the 2,180,286 shares presented by Coogan, Susan Coogan and Crui[c]kshanks were void as a matter of law and because no less than 1,941,788 proxies had been fraudulently voted by Coogan.
>
> 225. The beneficial owners of 1,941,788 shares withheld their proxies and, in reliance on the proxy representations, gave no instruction to the nominee title holder clearing house for proposal number 2, the election of directors, and did not vote for Coogan's slate in the October 4, 2002 election. Accordingly, Coogan fraudulently presented no less than 1,941,788 false proxies to Attorney Jones.
>
> ***

> 228. Coogan, Susan Coogan and Cruickshanks . . . committed proxy fraud to pursue their unlawful and disloyal goals. . . . In September 2002, they falsely represented that street name shares would not be voted for election of directors and then sent out proxy cards by which the clearing house would exercise its discretion, voting with management, if the owner provided no instructions.

Complaint ¶¶ 221, 224-25, 228.

16. In the Motion for Sanctions, the Defendants correctly explained that this asserted proxy misrepresentation could not possibly have affected the outcome of the October 2002 Election inasmuch as, regardless whether the 1,941,788 proxies were or were not voted in favor of the Coogan slate, the slate still would have received a plurality – a sufficient number to carry the election. *See* Motion for Sanctions at 20-22 & n.12. Thus, the asserted misrepresentation could not under any circumstances have been an "essential link" to the challenged transaction. In short, under the clear authority of *Virginia Bankshares* and *Royal Business Group*, the claim as pleaded had no chance whatsoever of success. It was frivolous.

17. Advisory Committee notes to Rule 11 provide, in relevant part:

> The rule [as revised in 1993] continues to require litigants to "stop-and-think" before initially making legal or factual contentions. It also, however, emphasizes the duty of candor by subjecting litigants to potential sanctions for insisting upon a position after it is no longer tenable and by generally providing protection against sanctions if they withdraw or correct contentions after a potential violation is called to their attention.
>
> The rule applies only to assertions contained in papers filed with or submitted to the court. . . . However, a litigant's obligations with respect to the contents of these papers are not measured solely as of the time they are filed with or submitted to the court, but include reaffirming to the court and advocating positions contained in those pleadings and motions after learning that they cease to have any merit.

Fed. R. Civ. P. 11 advisory committee's note (1993 amendments); *see also, e.g., Harlyn Sales Corp. Profit Sharing Plan v. Kemper Fin. Servs., Inc*., 9 F.3d 1263, 1269 (7th Cir. 1993) ("The complaint need not and should not contain citations or legal argument. To find out whether it was the opening shot in a campaign for some new legal principle, a court must examine what lawyers later say about their work.

[T]he only way to find out whether a complaint is an effort to change the law is to examine with care the arguments counsel later adduce.") (citation and internal punctuation omitted).

18. The Attorneys not only failed to withdraw Count X within the safe-harbor period after being advised of its lack of merit but also propounded further frivolous refinements and theories in a doomed attempt to save it.

19. In responding to the motions to dismiss, the Attorneys initially relied, *inter alia*, on the argument Carnathan now concedes was wrong: that, as a factual matter, the alleged proxy misrepresentation affected the outcome of the election because "if the Plaintiffs had been correctly informed that they needed to issue instructions to their brokers, they would have voted their shares against the Defendants." Dismiss Opposition at 13 (emphasis in original). As Carnathan now acknowledges, the October 2002 Election was uncontested. Only a plurality (that is, even one vote) was needed to win the election, and there was no option to vote "against" the Coogan slate.[10]

20. In their surreply, realizing belatedly that Count X as pleaded did not state a claim, the Attorneys retooled their section 14(a) theory, identifying a new alleged misrepresentation: that in his

[10] The Attorneys also relied at that time (and continue to rely) on an additional transaction-causation theory: that Coogan's alleged proxy misrepresentation regarding the manner in which shares would be voted affected the outcome of the election inasmuch as (i) per 13-A M.R.S.A. § 608(4), shares cannot be counted toward a quorum "if for any reason they may not lawfully be voted at such meeting[,]" (ii) in reliance on Coogan's statements, the Plaintiffs withheld instructions from their brokers with the intention that their shares not be voted in favor of the Coogan slate, (iii) Coogan nonetheless fraudulently voted those shares in favor of his slate, (iv) inasmuch as those shares could not "lawfully be voted," they should not have been counted toward a quorum, and, (v) accordingly, there was no quorum. *See* Dismiss Opposition at 13; *see also* Attorneys' Pre-Hearing Memo at 19-20. For reasons discussed in the Recommended Decision, the proposition that the shares in question could not "lawfully be voted" pursuant to 13-A M.R.S.A. § 608(4) is at best dubious. *See* Recommended Decision at 28 n.25. However, even assuming *arguendo* that this contention is colorable, transaction causation still is not shown. The outcome of the election still would have been exactly the same; indeed, no one could have known until election day whether the shares in question would be fraudulently voted. While the alleged fraud might have provided a basis for an after-the-fact argument that the election should be voided pursuant to 13-A M.R.S.A. § 608(4) for lack of a quorum, that is not the sort of direct causal nexus between misrepresentation and transaction that the caselaw contemplates as establishing transaction causation for purposes of a section 14(a) claim. *See, e.g., Royal Bus. Group*, 933 F.2d at 1063 ("The plaintiffs did not plead, and are unable on the facts as disclosed to (*continued on next page*)

September proxies, Coogan falsely stated that unless a shareholder whose shares were held in street name returned a signed proxy, such shares would not be counted for quorum purposes. *See* Plaintiffs' Surreply to Defendants' Replies in Support of Their Motions To Dismiss ("Dismiss Surreply") (Docket No. 63) at 2.

21. The new theory was seriously flawed in at least two fundamental respects. First, it was not pleaded in the Complaint, as the PSLRA demands. *See* Recommended Decision at 26. Second, and even more troubling, the underlying documents themselves could not reasonably be construed as setting forth the alleged misrepresentation. *See id*. at 26-27.

22. Undeterred, in the context of objecting to the Recommended Decision, the Attorneys reworked their section 14(a) claim yet again. This time they asserted that Coogan's September proxy statements regarding existence of a quorum were misleading when viewed against the backdrop of the proxy statement issued on August 16, 2002 by Firstmark. *See* Objection to Recommended Decision at 9-13. This latest iteration of the section 14(a) claim was neither pleaded in the Complaint nor aired during briefing of the motions to dismiss – despite the fact that the Plaintiffs were permitted to file a surreply. Worse, the Attorneys now were alleging the existence of an actionable fraud by Coogan based on his asserted failure to correct a misimpression left by wording in a proxy statement with which he had nothing to do.

23. After making this doomed argument, the Attorneys alternatively suggested (for the first time) that the Plaintiffs should be given leave to amend the Complaint with respect to their section 14(a) claim to the extent Judge Hornby found a "mere pleading deficiency." *Id*. at 14. Nonetheless, the Attorneys never tendered a proposed amended complaint. In any event, such a proposed amendment would have been

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prove, that the expense of their now lamented proxy contest resulted from any transaction that the shareholders (*continued on next page*)

futile: The September proxies simply cannot reasonably be construed to make the misrepresentation claimed.

24. Testimony taken, and argument heard, at the Rule 11 Hearing further highlighted the frivolous character of the section 14(a) claim. As counsel for the Defendants argued, the Attorneys' theory as ultimately refined presupposed that Coogan's misleading proxy statements thwarted an effort by Gorman and his allies to prevent the October 2002 Election from ever taking place. Yet it defies reason that Gorman would have attempted to do so. Only a few weeks earlier, he had entered into a settlement agreement with the Coogans contemplating that subsequent to the October 2002 Election, the Coogans would file an amended complaint in *Coogan v. Firstmark* deleting several objectionable allegations and then dismiss that complaint. Had Gorman deliberately attempted to prevent the existence of a quorum at that election, he would have jeopardized that agreement. To the extent that there could be any doubt, Gorman himself testified at the Rule 11 Hearing that he assumed there would be a quorum at the October 2002 Election, and Carnathan testified that neither Gorman nor Rechner informed him he would have sought to prevent a quorum if properly instructed.

25. In short, Count X was frivolous for lack of transaction causation, as the Defendants pointed out in the Motion for Sanctions served in August 2003. The Attorneys not only failed to withdraw this claim within the safe-harbor period but also persisted in fruitless efforts to redefine and save it – a "moving target" litigation strategy that put their opponents to added and needless expense.

26. **Counts XI and XII (sections 14(d) and 14(e) claims)**: The Motion for Sanctions outlined two grounds for a finding of the frivolousness of both Counts XI and XII: (i) that the Complaint

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authorized (or defeated) in consequence of management's allegedly improper proxy materials.").

failed to allege facts pursuant to which the court could find the existence of a tender offer, and, (ii) in any event, inasmuch as the Plaintiffs alleged that Coogan's post-tender-offer conduct, rather than his supposed Williams Act violations, caused their injuries, settled law foreclosed the tender-offer claims. *See* Motion for Sanctions at 24-29.

27. Although I agreed with the Defendants that Counts XI and XII should be dismissed on both of these alternative bases, *see* Recommended Decision at 29-34, these claims were not frivolous for those reasons.

28. As the Defendants themselves noted, "courts have used a variety of tests to determine the existence of a tender offer[.]" Motions for Sanctions at 25. These tests, in turn, involve evaluation of multiple factors and the exercise of significant discretion as to whether various groupings of factors, not all of which must be present, do or do not paint the portrait of a tender offer. *See, e.g.*, Recommended Decision at 31-33 (discussing nature of tender-offer analysis).

29. While I was persuaded that the Complaint did not portray a tender offer, the claim that it did was colorable. The Complaint alleged, for example, that (i) Coogan's goal as of mid-June 2002 was to acquire sufficient shares to take control of the Board, *see* Complaint ¶¶ 173-74, (ii) he approached a number of Firstmark shareholders, *see id.* ¶ 176, (iii) he made specific false and misleading statements to them that one reasonably could infer were intended to pressure them to sell their shares, *see id.* ¶¶ 176-81, and (iv) within a short period of time he did acquire the sought-after control piece, *see id.* ¶ 184. These are among recognized indicia of a tender offer under at least one leading multi-factored test (the so-called *Wellman* test, named for *Wellman v. Dickinson*, 475 F. Supp. 783 (S.D.N.Y. 1979), *aff'd*, 682 F.2d 355 (2d Cir. 1982)). *See, e.g., SEC v. Carter Hawley Hale Stores, Inc.*, 760 F.2d 945, 947, 950 (9th

Cir. 1985) (noting that *Wellman* factors include "[a]ctive and widespread solicitation of public shareholders for the shares of an issuer[,]" and the subjecting of an offeree "to pressure to sell his stock[.]").

30. I turn to the second of the Defendants' two original grounds for contending that Counts XI and XII were frivolous. The Defendants posited that the sections 14(d) and 14(e) claims were fatally flawed for lack of so-called "loss causation": in other words, that the Williams Act violations were not the cause of the Plaintiffs' claimed injuries. *See* Motion for Sanctions at 26-28. Their argument rested on their construction of Counts XI and XII as alleging that the Plaintiffs' injuries resulted from Coogan's post-tender-offer, post-election looting and mismanagement. *See id*. at 27 ("[T]he supposed 'tender offer' itself is not alleged to be the cause of Plaintiffs' putative injury. Rather, Plaintiffs' theory of liability is that 'Coogan, through misstatements and omissions in his tender offer, has been able to usurp and manipulate the Company's corporate machinery and engage in unlawful and self-dealing corporate transactions.'")(quoting Complaint ¶ 319).

31. The Attorneys do not dispute that a plaintiff asserting violations of sections 14(d) and 14(e) must allege and prove loss causation, which they acknowledge "requires that the plaintiffs allege injury as a result of [a corporate] transaction." Attorneys' Pre-Hearing Memo at 25. However, subsequent to the service of the Motion for Sanctions, in response to the loss-causation argument made in the motions to dismiss, they argued that the Defendants had misapprehended the gravamen of the tender-offer claims:

> The Defendants' contention that the Plaintiffs must connect their Section 14 claims to some transaction after the election that caused the Plaintiffs "pecuniary injury" is legally incorrect. The fundamental injury that the plaintiffs suffered in this case consisted of the wrongful election, by which Coogan usurped corporate control and impaired the shareholders' right to vote in the corporate democracy through, *inter alia*, false and materially misleading statements of fact, intention and belief.

Dismiss Opposition at 15. Their interpretation of the gravamen of the Complaint is plausible. *See, e.g.*, Complaint ¶ 318 ("[T]he plaintiffs were injured by Coogan's misrepresentations and omissions in that Coogan has been able through his deceptions to undermine the Company's shareholder democracy, deny shareholders their right to vote their shares knowledgeably, secure more than 50% of the outstanding shares of the Company, and unlawfully take control of it.").[11] Accordingly, Counts XI and XII were not frivolous on the basis specifically raised in the Motion for Sanctions.

B. Mandatory PSLRA Review

32. The PSLRA requires a reviewing court, upon final adjudication of a securities-law action, to "include in the record specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion." 15 U.S.C. § 78u-4(c)(1). In this case, those documents are the Complaint, the TRO/PI Motion, the Motion To Dismiss and the Motion for Sanctions, each of which I address in turn.

a. The Complaint

33. **Rule 11(b)(2) (frivolousness)**. I incorporate by reference the foregoing proposed conclusions of law.

[11] Although I am constrained to find this reading of the Complaint plausible, I note that (i) at the Rule 11 Hearing, Gorman indicated that the post-election looting and mismanagement was indeed what compelled him to initiate the instant suit, and (ii) even in their memorandum denying that the post-election conduct formed the gravamen of the Complaint, the Plaintiffs seemed in the same breath to acknowledge that it was. *See* Recommended Decision at 33-34. To the extent that the post-election conduct was indeed the target of the Williams Act Claims, they were frivolous. *See id.*; *see also, e.g.*, *United Canso Oil & Gas Ltd. v. Catawba Corp.*, 566 F. Supp. 232, 237 (D. Conn. 1983) ("Efforts to dress up claims of mismanagement or breach of fiduciary duty on the part of corporate executives in a § 14(a) suit of clothes have consistently been rejected[.]") (citation and internal punctuation omitted).

34. Since service of the Motion for Sanctions in August 2003, the Defendants have made one further argument that bears on the issue of whether sanctions should be imposed pursuant to Rule 11(b)(2).

In their pre-hearing memorandum, they contended:

> As plaintiffs came to concede, the only way they could challenge the October 2002 election – according to plaintiffs, the sole focus of their securities claims and thus the sole basis for federal jurisdiction – was to set forth some theory under which the 1.9 million shares alleged to have been improperly voted in favor of Coogan's slate should not have been counted as present for quorum purposes. Yet plaintiffs still have not and cannot point to any basis for the theory advanced in their surreply – that Mr. Gorman specifically intended to prevent the establishment of a quorum and thus prevent the election from taking place altogether.

Defendants' Pre-Hearing Memo at 8 (citations and footnote omitted). They added in a footnote: "The 400,000-plus shares allegedly acquired in violation of sections 13(d), 14(d) and 14(e) were of no moment to the outcome of the election." *Id*. at 8 n.4 (citation omitted). Although not labeled as such by the Defendants, this global argument implicates the notion of "transaction causation."

35. At the Rule 11 Hearing, Carnathan protested that the global transaction-causation argument improperly collapsed all of the Williams Act Claims when, in fact, it pertained only to the section 14(a) claim. I agree that the Defendants painted with too broad a brush.

36. I appreciate that the genesis of the Defendants' transaction-causation argument is a concession by the Attorneys themselves. In opposing the motions to dismiss, they had stated: "The wrongful October 2002 Election is the corporate transaction that the Plaintiffs challenge in their federal securities claims." Dismiss Opposition at 13.

37. Nonetheless, the concept of transaction causation contemplates a link between a particular misrepresentation and a particular corporate transaction. *See, e.g*., 1 Brian E. Pastuszenski, Christopher F. Robertson & Dean J. DiPilato, *Loss Causation in Securities Litigation: A Defense Strategy Whose*

Time Has Come, ALI-ABA Course of Study Materials: Securities Litigation (May 2003) ("Pastuszenski") ("Courts equate transaction causation to the 'but for' causation requirement in common law tort actions. It requires plaintiffs to plead and prove only that they would not have purchased the stock or engaged in the transaction but for the defendant's allegedly fraudulent statement or omission.") (footnote omitted).

38. The Attorneys' failure, in the context of the section 14(a) claim, to establish any transaction-causation linkup between Coogan's September proxy statements and the outcome of the October 2002 Election cannot simply be imputed to the remaining three Williams Act Claims, which addressed purported conduct of Coogan occurring prior to issuance of those proxy statements. The sections 13(d), 14(d) and 14(e) claims accordingly are not frivolous on this basis.

39. **Rule 11(b)(1): Improper Purpose**. Professors Charles Alan Wright and Arthur R. Miller have noted:

> The improper purpose clause is applied by most courts by using an objective standard. Some courts, however, retain subjective criteria within the improper purpose element of the rule, which helps take the strike out of strike suits. These cases support the argument that some subjective aspects of the original rule's certification standard have survived the 1983 amendment. As one commentator has observed, "[a]lthough courts and commentators have stressed that rule 11 introduces an objective standard to measure a lawyer's conduct, it is more accurate to say that the rule adds an objective layer to the subjective core of traditionally sanctionable bad faith conduct."

5A Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedur*e § 1335, at 85 (2d ed. 1990) (footnotes omitted).

40. Inasmuch as appears, the First Circuit is among courts that have discerned a continuing role for subjective criteria. While improper purpose can be inferred from objective facts and circumstances, *see, e.g., Kuck v. Bensen,* Civ. A. No. 86-0060-P, 1987 WL 61952, at *4 (D. Me. Oct. 21, 1987) (noting that for Rule 11 purposes record would support inference of existence of bad faith), the existence of

"subjective bad faith" remains relevant, *see, e.g.*, *Lancellotti*, 909 F.2d at 20 ("Amended Rule 11 sets up an objective standard of reasonableness under the circumstances. That standard is transgressed by (1) a violation of either subpart of the 'reasonable inquiry' clause, or (2) a violation of the 'improper purpose' clause. In effect, the court below impermissibly merged the two clauses; subjective bad faith, i.e., lack of an improper purpose, no matter how abundant, does not absolve a lawyer's or litigant's failure to conduct a reasonable inquiry into the facts and the law.").

41. In the Initial Hearing Notice, I notified Gorman and the Attorneys that although there was no direct evidence of improper purpose on the part of any of them, certain facts (in particular, (i) the backdrop to the instant litigation, which included the prior *Coogan v. Firstmark* battle for control, (ii) the filing of a ninety-three page purportedly verified complaint replete with non-cognizable allegations, and (iii) tenacity in pressing even apparently frivolous claims in the face of the Motion for Sanctions) raised a reasonable inference of improper motive on their part. *See* Initial Hearing Notice at 3-4.

42. In addition, at oral argument at the close of the Rule 11 Hearing, counsel for the Defendants contended that he had come to view this entire action – as the Attorneys have clarified its contours – as an unwarranted attack on the first action (in particular the Settlement Agreement), evidently designed to force a buyout of Gorman by Coogan or *vice versa*. He observed that: (i) in August 2002, in accordance with the terms of the Settlement Agreement, Gorman and the other Texas Directors resigned from the Board and the Coogans joined the Board, (ii) as of then, the Board consisted of three directors: the Coogans and Ali Ezami, (iii) the Settlement Agreement contemplated, and both sides understood, that the election would take place, following which Coogan would file an amended complaint in *Coogan v. Firstmark* expunging certain allegations unfavorable to Gorman and dismiss that complaint; (iv) any move by Gorman to have prevented the October 2002 Election from taking place would have jeopardized the Settlement Agreement; and, (v) in

any event, even had that election not taken place, control would not have reverted to Gorman and his allies, but rather to the existing directors, the Coogans and Ezami, who would have been entitled to fill vacancies on the Board.

43. I am satisfied that the totality of the evidence suffices to rebut inferences of improper purpose on the part of the Respondents.

44. As an initial matter, I note that the Defendants' improper-purpose argument hinges, at least in part, on their further contention that all of the Williams Act Claims collapse into the Attorneys' theory that Gorman and his allies, if properly instructed, would have sought to prevent a quorum at the October 2002 Election. As discussed above, I find that the Attorneys proffered that theory only with respect to one of the Williams Act Claims – the section 14(a) claim. The Defendants have articulated no other persuasive basis on which to find the remaining Williams Act Claims frivolous.

45. While the Attorneys' section 14(a) theory, as originally articulated and as finally crystallized, is indeed so flawed as to be frivolous, does that mean that the Attorneys or Gorman deliberately brought frivolous claims in the face of the Settlement Agreement to force the long-sought buyout of Gorman by Coogan or *vice versa*? I do not think so.

46. Gorman credibly testified, and the Attorneys corroborated, that he instigated this lawsuit because he and other shareholders were deeply upset by the direction in which Firstmark was going. Ezami, whom Gorman had been led to believe was critical to the company's success, had been fired; a number of other workers had been laid off; several of Coogan's hand-picked board members had resigned shortly after taking office; the company's business was spiraling downward; and the Coogan board arranged to deregister the company with the SEC – a step that would relieve Firstmark of the need to make public filings. That Gorman, who as a minority shareholder did not hold sufficient stock to defeat Coogan in

a Board election, sought refuge in the shelter of litigation is understandable. While it is clear that Gorman sought, and got, an "aggressive" team of attorneys, he credibly testified, and the Attorneys corroborated, that (i) he wanted the litigation to be conducted as expeditiously as possible, (ii) he relied on the Attorneys to craft the legal framework of the case, and (iii) he received assurances from the Attorneys, on receiving the Motion for Sanctions, that it had no more than a minimal chance of success. I therefore conclude that Gorman harbored no improper purpose in filing the Complaint or in continuing to conduct this lawsuit following the filing of the Motion for Sanctions.

47. Carnathan – the lead draftsman – credibly testified that he devoted hundreds of hours to preparation of this case, that he was familiar with his obligations under Rule 11, that he believed the claims to have been sound, and that he had nothing personally to gain beyond compensation for work performed. In particular, he studied the Settlement Agreement and other *Coogan v. Firstmark* materials in some detail, considered whether they posed a direct bar to this action and analyzed whether a plaintiff such as Gorman has standing to bring the Williams Act Claims. Upon receiving the Motion for Sanctions, he saw to it that an associate pulled every case cited, and he personally read them all. He sincerely concluded that the motion had at best a small chance of success. This was not such a blatantly absurd conclusion as to render his testimony suspect: I have recommended that the motion be granted with respect only to Count X. Concededly, he exercised poor judgment in bringing and continuing to press the section 14(a) claim and in failing to make reasonably clear, in a timely fashion, that the Plaintiffs pressed no section 13(d) claim. However, under the circumstances of this complicated case, I do not discern that his poor judgment translates into "improper purpose."

48. I turn finally to Goren, the lead theorist and investigator. Although Goren made intemperate remarks about Coogan and Ball in Anders' presence, I am not inclined to view those as evidence of

improper purpose. In context, his comments appear to have been the product of a mix of frustration arising from a contentious discovery dispute, misplaced cockiness and zeal for the cause of his client. Goren, like Carnathan, credibly testified that he devoted hundreds of hours to preparing this case to the best of his ability and that he was familiar with Rule 11 and believed himself to have been in compliance with it. He, like Carnathan, exercised poor judgment with respect to the section 14(a) and 13(d) claims. Yet, under all of the circumstances, I find that he, as well, harbored no improper purpose.

49. **Recommended Sanctions**. The PSLRA requires the court to "adopt a presumption that the appropriate sanction . . . for substantial failure of any complaint to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred in the action." 15 U.S.C. § 78u-4(c)(3)(A)(ii). This presumption may be rebutted only upon proof that:

> (i) the award of attorneys' fees and other expenses will impose an unreasonable burden on that party or attorney and would be unjust, and the failure to make such an award would not impose a greater burden on the party in whose favor sanctions are to be imposed; or
>
> (ii) the violation of Rule 11(b) of the Federal Rules of Civil Procedure was de minimis.

Id. § 78u-4(c)(3)(B).

50. The Complaint contains nineteen counts, fourteen of which the court never reached when it declined to exercise its supplemental jurisdiction over them. Without objection from the Defendants or the Respondents, I ruled that I would not weigh whether those fourteen claims were frivolous. *See* Second Hearing Notice. Under those circumstances, and given that the thrust of the PSLRA is to prevent abusive securities-law litigation, it seems to me appropriate to analyze whether a substantial violation is present on the basis of the universe of the Williams Act Claims alone. *See, e.g.*, *Gurary v. Nu-Tech Bio-Med, Inc.*,

303 F.3d 212, 224 n.5 (2d Cir. 2002) ("In dismissing Gurary's state law claim without prejudice, the district court did not make a specific factual finding with respect to whether this nonfederal allegation in the complaint was frivolous. Because [plaintiff's attorney] has not raised before this court the argument that his state law allegation suffices to make the complaint *as a whole* nonabusive, we need not consider this possible contention. Accordingly, we decline to decide whether the presence of a state law claim, if it has sufficient merit, may preclude a finding of a substantial failure to comply with Rule 11 in a federal securities action.") (citation omitted) (emphasis in original).

51. In a thoughtful opinion analyzing the circumstances in which it is appropriate to conclude pursuant to 15 U.S.C. § 78u-4(c) that a complaint substantially violates Rule 11, the Court of Appeals for the Second Circuit stated:

> Nu-Tech argues that a substantial violation occurs whenever the nonfrivolous claims that are joined with frivolous ones are insufficiently meritorious to save the complaint as a whole from being abusive. Under this interpretation, the district court must examine the qualitative substance of the nonfrivolous claims in order to assess whether these claims were, in fact, legitimate filings that had the potential of prevailing or whether they patently lacked merit and only narrowly avoided being deemed frivolous themselves.
>
> There is much to be said for this reading of the statute, and we adopt it today.
>
> ***
>
> To summarize: in cases of this sort, the district court must first determine whether frivolous claims in violation of Rule 11 have been brought. If they have, the court must examine whether nonfrivolous claims have been joined and, if so, whether these claims – whatever their number – are of a quality sufficient to make the suit as a whole nonabusive and the Rule 11 violation not substantial. If no such weighty frivolous claims are attached, the statutory presumption applies. The court must then determine whether the violation was de minimis, for, if it was, the presumption is rebutted.

Gurary, 303 F.3d at 222-23 (2d Cir. 2002) (footnote omitted).

52. The Plaintiffs alleged four substantive Williams Act violations. As discussed above, their section 14(a) claim – contained in Count X – was frivolous at its inception on the basis of lack of transaction causation, and the Attorneys persisted in proffering further frivolous refinements and theories in a failed attempt to save it. The Attorneys also failed to clarify, in timely fashion, that they were not asserting a section 13(d) claim for damages that, itself, barely survives frivolousness scrutiny. Nonetheless, the Defendants have not shown, nor have I otherwise discerned, that the remaining claims – the section 13(d) claim insofar as it sought injunctive relief and the section 14(d) and 14(e) claims – either were frivolous or borderline-frivolous or that the action as a whole was pursued for an improper purpose. Therefore, I conclude that the Complaint as a whole does not substantially violate Rule 11.

53. In circumstances in which a complaint is not found to have substantially violated Rule 11, there is no applicable sanctions presumption. Instead, the PSLRA simply directs that the court impose sanctions in accordance with Rule 11. *See* 15 U.S.C. § 78u-4(c)(2). Rule 11 provides, in relevant part:

> A sanction imposed for violation of this rule shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated. Subject to the limitations in subparagraphs (A) and (B), the sanction may consist of, or include, directives of a nonmonetary nature, an order to pay a penalty into court, or, if imposed on motion and warranted for effective deterrence, an order directing payment to the movant of some or all of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation.

Fed. R. Civ. P. 11(c)(2).

54. In accordance with the foregoing, I recommend that the court enter an order directing payment to the Defendants by the Attorneys and their law firm of the total of reasonable attorney fees and other expenses incurred as a direct result of the Attorneys' having brought, and continued to press, refine and defend, Count X (including in the context of the instant Motion for Sanctions and mandatory PSLRA review). Should the court adopt this recommended decision, I further recommend that the court direct the

Attorneys and the Defendants to undertake a serious good-faith effort to reach agreement on a fee disposition consistent herewith in lieu of prolonging this litigation further.

b. TRO/PI Motion

55. No one has suggested that the Respondents (or any other party or attorney) transgressed Rule 11 with respect to the TRO/PI Motion, nor do I discern that anyone did.

c. Motions To Dismiss

56. No one has suggested that the Defendants or their attorneys transgressed Rule 11 in any respect by filing the motions to dismiss, nor do I discern that they did. Far from being frivolous, the motions presented well-researched, thoughtful and persuasive arguments for dismissal of the Complaint. To the extent that the Attorneys committed a Rule 11(b)(2) violation in opposing these motions, I have addressed that violation in the context of discussing the Motion for Sanctions, above.

d. Motion for Sanctions

57. Although I have recommended that the Motion for Sanctions be granted as to only one of the nineteen counts of the Complaint, the motion was not frivolous or imposed for an improper purpose. Without objection from the Respondents or the Defendants, I declined to consider any Rule 11 arguments directed toward the fourteen counts with respect to which the court declined to exercise its pendent jurisdiction upon dismissal of the Williams Act Claims. One of the non-meritorious Williams Act arguments – that pertaining to the availability of damages pursuant to section 13(d) – presented a close question, and the remainder were, at the least, colorable given the manner in which the Defendants reasonably construed the Complaint.

V. Conclusion

For the foregoing reasons, I recommend that the Motion for Sanctions be **GRANTED** as to Count X and otherwise **DENIED,** and that pursuant to its mandatory Rule 11 PSLRA review the court (i) find the Attorneys to have violated Rule 11(b)(2) with respect to Count X of the Complaint, (ii) find the Complaint nonetheless to be in substantial compliance with Rule 11, (iii) find no Rule 11 violation with respect to any dispositive motion filed in this case – with the exception of the Attorneys' defense of Count X in opposing the motions to dismiss – and (iv) impose sanctions payable to the Defendants by the Attorneys and their law firm in the amount of the reasonable attorney fees and other expenses incurred as a result of the Attorneys having brought, and continued to press, refine and defend, Count X Should the court adopt this recommended decision, I further recommend that the court direct the Attorneys and the Defendants to undertake a serious good-faith effort to reach agreement on a fee disposition consistent herewith in lieu of prolonging this litigation further.

NOTICE

A party may file objections to those specified portions of a magistrate judge's report or proposed findings or recommended decisions entered pursuant to 28 U.S.C. § 636(b)(1)(B) for which de novo review by the district court is sought, together with a supporting memorandum and request for oral argument before the district judge, if any is sought, within ten (10) days after being served with a copy thereof. A responsive memorandum and any request for oral argument before the district judge shall be filed within ten (10) days after the filing of the objection.

Failure to file a timely objection shall constitute a waiver of the right to de novo review by the district court and to appeal the district court's order.

Dated this 24th day of November, 2004.

/s/ David M. Cohen
David M. Cohen
United States Magistrate Judge

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